

Chapter 2 Contents

Section 1 – Introduction to Fund Balance/ Net Assets

Section 2 – Determining Fund Balance

Section 3 – Special Considerations

SECTION 1
INTRODUCTION TO FUND BALANCE/NET ASSETS

A) DEFINITION

Fund balance is defined as the difference between the assets and liabilities of a fund. Fund balance is terminology that is applicable to “fund level” reporting of individual governmental funds and is based on the modified accrual basis of accounting. It is used as a measure of the amount available to budget or spend in the future.

Net assets is defined as the difference between assets and liabilities of the governmental entity as an entire unit. Net assets is terminology that applies to “government wide” financial statements and is based on the full accrual basis of accounting. It is intended to measure the extent to which the government’s taxpayers have paid the cost of services provided to date.

B) CATEGORIES

Fund balance of governmental libraries can be divided among three categories:

- Reserved (restricted) fund balance

The portion of fund balance that is legally segregated for a specific purpose and is not available for general expenditures. A common example would be unspent earmarked tax collections or donations restricted by the donors for specific purposes.

- Unreserved (unrestricted), designated fund balance

The portion of fund balance that is set aside by the library’s governing body or by library management, indicating the tentative future purpose of fund balance. For example, library board of trustees may designate fund balance for future capital acquisition needs.

- Unreserved (unrestricted), undesignated fund balance

The portion of fund balance that represents available resources to finance expenditures that are not reserved or designated.

Net assets of government wide financial reports is classified among three categories:

- Invested in capital assets, net of related debt.

This component consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any debt that is attributable to those assets.

- Restricted

Restrictions on net assets generally refer to constraints placed on the government by third parties or imposed by law through constitutional provisions or enabling legislation.

The financial statements should disclose the major categories of restrictions.

- Unrestricted

Unrestricted net assets is the default category for items that do not meet the definitions of the other two categories.

Designations of unrestricted net assets are not permitted to be reported on the face of the financial statements but may be disclosed in the notes.

C) **RULE OF THUMB**

A commonly recited “rule of thumb” is that unreserved, undesignated fund balance should equal at least 10 percent of annual budgeted expenditures. Careful consideration of a particular library’s specific facts and circumstances should be taken into account when comparing fund balance to the “rule of thumb.” Section 2 provides guidance for adjusting the 10 percent rule of thumb to an individual library’s needs. Analysis of fund balance for specific funds will continue to be important since they reflect the current financial resources measurement focus basis of accounting and are an indicator of the ability to provide services on a near term perspective.

Because the new reporting model required by GASB Statement number 34 is so new, there has not yet been any guidance developed regarding appropriate or desirable levels of net assets. Key measurements included in the MD&A will include whether net assets increased or decreased, including an analysis of the factors that caused the change. The analysis of net assets will become increasingly important as it is a measurement of the total economic resources measurement focus basis of accounting and is an indicator of the long term investment in economic resources that are necessary to provide services on a long term perspective.

SECTION 2 DETERMINING FUND BALANCE

The appropriate amount of fund balance should be determined annually, in accordance with management's fiscal philosophy, future plans, needs or situations, such as:

- Planned Capital Asset Purchases
- Accumulation of Compensated Absences (vacation and sick time due to employees)
- Contingent Liabilities
 - Lawsuits
 - Environmental cleanup
 - Michigan Tax Tribunal (property tax value protests)
- Potential Revenue Reductions (i.e., changes in state shared revenue)
- Legally Reserved or Segregated Funds
 - Advance or unspent earmarked tax collections or other receipts
 - Grants or contributions (endowments)
- Working Capital Needs Based on Expenditure Patterns

In summary, there is not a preconceived or correct amount of fund balance that a library should have. The appropriate amount of fund balance will depend on many facts and circumstances. It is the library's legislative body and the management team who should determine what the appropriate amount should be, based on the facts and circumstances of the library. Determining the fund balance goes hand in hand with determining the library's annual budget. Refer to the Budgeting chapter for further discussion.

SECTION 3 SPECIAL CONSIDERATIONS

A) DIFFERING YEAR-ENDS

Consideration should be given to the library's fiscal year in relation to its tax collection period (and by default, to the time remaining until the next "payday"). Tax collections in one year that are for the following year's budget should either be classified as deferred revenue or designated fund balance.

For example, a library with a December 31 year end collects its tax revenue in the beginning of each fiscal year and the majority of the tax collections are used in the same fiscal year. In contrast, a library with a March 31 year end collects its tax revenue at the end of each fiscal year and the majority of the tax collections are used in the following fiscal year. Therefore, the library with the March 31 fiscal year end may appear to have a larger fund balance in its annual report, but the fund balance must be used to support the following year's expenditures.

B) DEFICITS

State statutes require local units to adopt and file a deficit elimination plan in the event any governmental library fund has a fund balance deficit. The plan should be a simple explanation of how the library intends on eliminating the deficit. The plan should be sent to the following address:

State of Michigan
Local Audit and Finance Division
Department of Treasury
Treasury Building
Lansing, Michigan 48922
(517) 373-3227
www.treas.state.mi.us or
www.michigan.gov/treasury